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AGENDA ITEM 3

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: State Legislative Proposal: Inactive Member Group Terminations

II. PROGRAM: Legislation

III. RECOMMENDATION: Staff recommends that the Board **sponsor** legislation to allow CalPERS to enter into an agreement with a contracting agency to terminate inactive member groups.

IV. ANALYSIS:

This proposal would allow CalPERS to enter into an agreement with a public agency to terminate a portion of its contract with respect to inactive member groups and merge the inactive member group plan into the terminated agency pool. A public agency that elects to terminate an inactive member group would be responsible for sufficiently funding the retirement and death benefits of the members of the inactive member group. Any excess employer funds would not be refunded but rather merged into one of the employer's active plans. This legislation would establish the criteria under which contracting agencies may terminate inactive member groups in coordination with current contract termination sections

BACKGROUND

Inactive Member Group

A public agency contract for participation in the retirement program generally covers the agency's miscellaneous, fire and police members. When the agency no longer has active employees in one of the three groups, that member group, along with the members in that group, becomes inactive. An Inactive member group may consist of members that transferred to another CalPERS agency; separated, but did not refund; and retirees or beneficiaries receiving benefits.

One example of how a member group may become inactive is when a city contracts with a county for fire services. Those city fire safety plan members are typically transferred to the county. The city's fire safety plan now becomes inactive because it no longer has active employees in the fire safety plan.

Under current law, an inactive member group plan must remain open indefinitely and the Actuarial Office performs annual actuarial valuations. Since these plans do not contain active members, contributions must be collected outside the normal payroll reporting process. If the annual valuation for an inactive member group plan results in an actuarially required employer contribution, an invoice is generated and the employer is asked to remit a lump sum payment. However, if the annual valuation shows a surplus, the excess assets can not be refunded to the employer, nor can they be transferred to fund accounts for active member group plans.

In 2003, the Board adopted a resolution creating ten risk pools, including the Inactive Plan Pool. This risk pool contains 108 inactive member group plans and is 102 percent funded (as of June 30, 2006).

Terminated Agencies

Existing law contains provisions for the voluntary and involuntary termination of local agency contracts. The provisions governing voluntary terminations basically require a notice of intent to terminate the contract followed by the adoption of a resolution or ordinance terminating the contract not less than a year later. The provisions governing involuntary terminations provide CalPERS the authority to terminate a contract if (a) the contracting agency fails to pay an installment of required contributions for 30 days after a demand for payment, (b) the contracting agency fails to provide information required for the administration of the system for three months after a demand for the information, or (c) CalPERS determines that the agency no longer exists.

When an agency contract is terminated its assets and liabilities are determined. The assets and liabilities are then placed in a separate pooled account (i.e., the Terminated Agency Pool) to provide benefits to former members of plans of agencies that have terminated their contracts. If the assets are greater than the liabilities, the agency is paid the difference based on the market value of plan assets as of the most recent annual closing. If the liabilities are greater than the assets, the terminating agency is required to pay CalPERS the difference. If it fails to do so, the agency is declared to be in default and benefits may be reduced proportionate to the amount the agency failed to provide CalPERS to fund the members' earned benefits, or the members could be provided full benefits if it is determined by the Board not to impact the soundness of the Terminated Agency Pool.

The Terminated Agency Pool currently consists of 110 members and is 323 percent funded.

DISCUSSION

The current structure for dealing with inactive member groups is inefficient. An inactive member group plan that is underfunded is required to make installment payments, while an inactive member group plan with a surplus does not have access to this money to offset payments to one of its active plans. Allowing CalPERS to enter into an agreement with agencies to terminate the inactive member group plans and place them in the Terminated Agency Pool eliminates time consuming actuarial valuations, a separate billing process, and provides employers with access to surplus assets. Members whose agencies terminate their CalPERS plans will have their benefits protected when they are added to the Terminated Agency Pool.

Under current law a public agency that terminates their contract can elect to either freeze final compensation at the time of termination, or provide for reciprocity. By freezing final compensation at the time of termination, the member's benefits would be frozen and calculations would be based on the benefit level in effect on the date the inactive member group is terminated. If final compensation is unfrozen, then their benefits would be calculated in the same manner as for active member groups. Choosing final compensation at termination may negatively impact future retirement allowances for inactive member groups with transferred or separated members. This same choice will be provided to public agencies that choose to terminate an inactive member group.

PROPOSED CHANGES

This proposal would make the following changes in existing law:

1. Authorizes the Board to enter into an agreement with a public agency to terminate a portion of its contract with respect to inactive member groups.

2. Authorizes the Board to perform the final calculation of assets and liabilities of the terminated inactive member group.

3. Provides that any surplus of assets of an agency will be merged into the active plan(s) of the contracting agency.

4. Provides that the agencies that terminate an inactive member group will be responsible for sufficiently funding retirement and death benefits for those members and beneficiaries who remain.

5. Authorizes the Board to move terminated inactive member groups into the Terminated Agency Pool, thus following the same laws as contract terminations.

V. STRATEGIC PLAN:

This proposal supports Strategic Goal III to develop, design, and administer benefit programs and business processes that are innovative, effective, efficient, and valued by our members, employers, and stakeholders.

VI. RESULTS/COSTS:

This proposal would allow CalPERS to enter into contracts with public agencies to terminate inactive member groups.

Program Cost:

No program costs are anticipated from this legislation. An employer who elects to terminate an inactive member group would not be responsible for any additional contributions than it is already responsible for contributing. However, if an employer has excess assets, it could benefit by merging these assets to one of its active plans. Members whose agencies terminate their CalPERS plans will have their benefits protected when they are added to the Terminated Agency Pool, which is currently 323 percent funded.

Administrative Cost:

This bill may create some additional workload for Actuarial and Employer Services Division and Fiscal Services Division initially, but would eliminate unnecessary annual valuations in the long term.

When an agency terminates, CalPERS negotiates with the contracting agency a plan for payment of the unfunded liability.

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